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AGRICULTURAL LENDING ATTITUDES, PRACTICES AND ACTIVITIES OF OHIO COMMERCIAL BANKERS

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The importance of banker attitudes has been frequently alluded to in connection with discussions focusing upon the future role of commercial banks in the field of agricultural credit. The implication has been that the future role of banks in the field of farm credit is dependent upon favorable banker attitudes toward agricultural lending as well as upon facilitating an increase in the flow of funds via the banking system to the rural sector. However, little empirical evidence exists to substantiate the assumption that a close relationship exists between the attitudes of commercial bankers and the commitment of their banks to agricultural lending.

The major objective of this research was to evaluate the future role of commercial banks in the field of farm credit on the basis of an examination of the agricultural lending attitudes, practices and activities of Ohio commercial bankers. Specifically, the objectives of this study were: (1) to determine the extent to which bankers held favorable or unfavorable attitudes toward agricultural lending; (2) to determine whether significant differences existed between the farm lending attitudes of different groups of bankers; (3) to determine whether the attitudes of bankers were significant indicators of the commitment of their banks to production agriculture; and (4) to evaluate the farm lending practices and activities of commercial banks in Ohio.

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Summary of Analytical Procedure

A mail survey questionnaire was developed in this research to obtain information about the attitudes of Ohio bankers toward agricultural lending as well as to obtain information about the farm lending practices and activities of commercial banks operating in Ohio. The survey questionnaire was mailed early in January of 1972 to 472 banks located outside the major metropolitan cities of Ohio.

The development and administration of Likert-type attitudinal scales constituted the basis for measuring the agricultural lending attitudes of Ohio commercial bankers. The attitudes of bankers were measured toward 7 farm lending attitudinal variables. These were: the future economic viability of the agricultural industry, the future extension of farm non-real estate credit, the management effectiveness of farmers, the adequacy of banking farm business services, the adequacy of the correspondent banking system's farm credit services, the credit risk associated with agricultural lending, and the future extension of farm real estate credit.

The technique of one-way analysis of variance was utilized to determine if any statistically significant differences existed between the attitudes of agricultural and non-agricultural bankers toward each of the above farm lending attitudinal variables. Agricultural bankers represented those surveyed banks with farm loan to total loan ratios of 25% or higher while all other surveyed bankers were defined as non-agricultural bankers.

The technique of step-wise multiple regression and correlation analysis was utilized to determine whether banker attitudes toward each of the farm lending attitudinal variables were significant predictors of the commitment of their banks to agricultural lending. For purposes of this research, the farm loan to total loan ratio for each of the surveyed banks was defined as an empirical indicator of commitment.

Information obtained about the farm lending practices and activities of commercial banks in Ohio was analyzed by means of frequency distributions and the construction of cross-classification tables for selected data obtained from the responses of bankers to questions in the survey questionnaire.

Summary of Attitudinal Findings

The results of the research revealed that the surveyed bankers generally held positive attitudes toward agricultural lending. Thus, it can be concluded that Ohio bankers view the extension of bank credit to farmers to be a viable form of business for their banks in the future. Specifically, positive attitudes were held by bankers toward the following farm lending attitudinal variables: (1) the future economic viability of the agricultural industry; (2) extending farm non-real estate credit to farmers in the future; (3) the management (farm and financial) effectiveness of farmers; (4) the adequacy of banking farm business services in terms of satisfying the special business service needs of their farm customers; (5) the credit risk associated with lending to farmers in terms of farmers being perceived as acceptable credit risks; and (6) extending farm real estate credit to farmers in the future.

In contrast, the surveyed bankers held negative attitudes toward the adequacy of the correspondent banking system's farm credit services. Consequently, it can be concluded that Ohio bankers generally feel that the correspondent banking mechanism is not adequately satisfying the service needs of rural banks in terms of providing rural banks with an important source of bank credit or with funds available outside of their own business service area.

The results of analysis of variance revealed that agricultural bankers held significantly more positive attitudes than non-agricultural bankers toward the future extension of farm non-real estate credit, the future extension of farm real estate credit, the management effectiveness of farmers, and the credit risk associated with agricultural lending. Conversely, significant differences between the attitudes of these two groups of bankers were not observed in regard to the future economic viability of the agricultural industry, the adequacy of banking farm business services and the adequacy of the correspondent banking system's farm credit services. Thus, it can be concluded that differences did exist between the attitudes of different groups of bankers toward at least some of the farm lending attitudinal variables used in this research. These differences probably can be attributed to the greater experience or greater involvement of the respondent agricultural bankers, as compared to non-agricultural bankers, in working with farmers on bank matters. In addition, the results of analysis of variance indicated that significant differences did not exist between the attitudes of the surveyed bankers toward the future extension of farm non-real estate credit versus the future extension of farm real estate credit. Therefore, it can be concluded that no differences existed in terms of bankers' perception of their future involvement in agricultural lending in regard to extending farm non-real estate credit and farm real estate credit respectively.

The results of multiple regression and correlation analysis revealed that banker attitudes toward each of the 7 farm lending attitudinal variables contributed to explaining only slightly more than 7 percent of the variation in commitment (the farm loan to total loan ratio). Only 2 of the farm lending attitudinal variables were statistically significant in terms of accounting for the variance explained in commitment. These 2 variables were banker attitudes toward extending farm non-real estate credit to farmers in the future and banker attitudes toward the farm and financial management effectiveness of farmers.

With respect to the major hypothesis of this research, these findings did not support the theoretical position that increases in the farm loan to total loan ratios of the surveyed banks would be significantly associated with increases in the favorability of the farm lending attitudes of the surveyed bankers. However, the very low amount of variation explained in commitment by the farm lending attitudes of the surveyed bankers was probably due to the operation of different lending constraints within the business of banking. For those bankers who exhibited high positive attitudes toward agricultural lending but whose banks exhibited low farm loan to total loan commitments, the desires of these bankers to extend credit to farmers may have been restrained by the economic and/or institutional framework or bank lending constraints under which they were operating as lending officers. In summary, on the basis of the very low amount of variation explained in commitment, it can be concluded that the attitudes of bankers are not significant predictors of the commitment of their banks to agricultural lending.

Summary of Farm Lending Practices and Activities of Commercial Banks in Ohio

From the 472 survey questionnaires mailed to Ohio Banks, usuable questionnaires were returned from 236 banks. Of these banks, 66 were classified as agricultural banks. The 236 respondent banks accounted for approximately 62 percent of the estimated total volume of farm loans outstanding at all commercial banks in Ohio at year-end 1970.

Agricultural banks were predominantly smaller banks in terms of deposit size and nearly all of these 66 banks held deposits of under $10 million. Conversely, more than one-third of the surveyed banks held deposits of $20 million and over at year-end 1970. A high proportion, nearly 63 percent of the deposits held by the surveyed banks, were in interest bearing accounts such as time and savings deposits.

Nearly half of the surveyed banks had loan-to-deposit ratios of more than 60 percent. Small banks with under $5 million in deposits exhibited loan-to-deposit ratios similar to those of banks with $20 million and over on deposit. Thus, the very small banks appeared to be just as aggressive as the very large banks in terms of their lending practices. Agricultural banks also exhibited high loan-to-deposit ratios. Approximately half of the respondent bankers expected their average annual loan-to-deposit ratio (58.5%) to increase over the next 1-5 years. Thus, even more aggressive lending policies for some of the surveyed banks can be expected in the future.

Agricultural banks accounted for 36 percent of the total outstanding farm loan volume reported by all respondent banks. In contrast, non-agricultural banks with $20 million and over in deposits but with farm loan to total loan portfolio commitments lower than agricultural banks held 41 percent of the reported total volume of farm loans.

Most of the surveyed banks with deposits of under $10 million could not make loans to individuals in excess of $100,000 because of the size of their legal loan limits. About 64 percent of the agricultural banks could not make loans to an individual borrower of more than $50,000. Conversely, all of the non-agricultural banks with $20 million and over in deposits could make individual loans greater than $100,000. As a result of the size of their legal lending limits, about 9 percent of the surveyed banks had received overline farm loan applications in 1970 which totaled over $4 million, while approximately 12 percent had received farm loan requests exceeding their legal loan limit in 1971, which totaled over $5 million. More than half of these banks held deposits of under $10 million and most were agricultural banks. Of the total dollar volume of overline farm loan requests received by these banks, approximately 23 percent was lost to other lenders or never granted in 1970, while about 40 percent was lost or never granted during 1971.

The above findings suggest that many of the banks with $20 million and over in deposits probably were meeting a higher proportion of the credit needs of farm borrowers requiring large loans, as compared to the smaller respondent banks, including some of the smaller agricultural banks. Specifically, this was indicated not only by the sizeable volume of farm credit held by these very large banks, but also by the magnitude of their legal lending limits. As farm numbers decline in Ohio, and the size of individual farming operations increases, the total debt financing requirements of farmers are expected to increase substantially over the next decade. While larger banks can be expected to accommodate some of these needs, small banks and especially agricultural banks which are heavily committed to agricultural lending probably will encounter significant problems in maintaining their share of the farm loan market unless they can find ways to increase the size of their legal loan limits and/or obtain funds from outside sources. It can be concluded that this will be a very important problem confronting the smaller banks in Ohio which rely heavily upon agricultural lending as a source of bank income.

A possible solution for alleviating the problem of overline loans for at least some smaller banks in Ohio would be to liberalize the present 10 percent legal lending limit restriction. However, most of the respondent bankers felt that the current 10 percent legal loan limit should remain at its present level in order to protect the solvency and liquidity position of their banks. Only about 15 percent of the bankers favored a more liberalized legal lending limit restriction. Moreover, nearly half of these bankers represented agricultural banks and they accounted for more than one-fourth of all the respondent agricultural bankers. Thus, it can be concluded that at least some of the banks heavily committed to agricultural lending are in favor of a more liberalized legal loan limit.

Approximately three-fourths of the surveyed bankers reported that the average net worth position (debt-to-worth ratio) of their farm customers had improved during the past five years. While this tended to indicate that most farm customers were not as highly leveraged now as they were five years ago, it could also mean that highly leveraged farmers are not seeking credit from banks but are seeking it from other sources. It may also mean that some of the banks are not extending bank credit to existing or to potentially highly leveraged farm borrowers. Overall, less than 3 percent of the surveyed bankers reported a decline in the average net worth position of their farm customers. In addition, the financial condition of most of the farm customers of the surveyed banks appeared to be relatively sound in terms of their debt servicing ability. In general, it can be concluded that most of the farm customers of Ohio banks are probably an acceptable credit risk on the basis of their net worth positions and debt servicing ability. The positive attitudes of bankers toward the credit risk associated with agricultural lending adds additional support to this finding.

Most agricultural and non-agricultural bankers reported that higher priorities were given to consumer instalment credit and residential mortgages within the loan portfolio composition of their banks as compared to farm non-real estate loans, farm real estate loans, and commercial and industrial loans. However, large banks with $10 million and over in deposits tended to give higher priorities to commercial and industrial loans compared to the two types of farm loans. Similar priorities were projected for these five types of bank loans over the next 1-5 years. Based upon the higher priorities the surveyed banks generally were giving to other bank loans versus farm non-real estate and farm real estate credit in their loan portfolios, it can be concluded that most banks in Ohio place a comparatively low priority on farm loans. Also, because similar priorities were projected for the above five types of bank loans over the next 1-5 years, it can be concluded that most Ohio banks probably will continue to place less importance upon farm loans as compared to other types of loans. Thus, while positive attitudes were held by the surveyed bankers toward extending farm non-real estate credit and farm real estate credit to farmers in the future, it can be concluded that bankers probably have even stronger preferences for extending consumer instalment credit and residential mortgages, and even in some instances for extending commercial and industrial loans.

With respect to future increases in the present total volume of farm credit handled by all of the surveyed banks, only about one-half of the banks reported that they planned to increase their total volume over the next 1-5 years. Thus, it can be concluded that the present share of the farm loan market held by banks in Ohio probably will not increase materially. In fact, it may tend to decline as Production Credit Associations and Federal Land Banks become even more aggressive in their farm lending programs.

Most of the farm loan customers of the respondent banks (about 80 percent) were required to submit a financial statement (net worth) as part of their loan application. An operating statement, farm budget or cash flow schedule was required from a much lower proportion of farm borrowers. However, banks with $20 million and over in deposits required the highest percentage of their farm borrowers to provide at least one or more of these three kinds of statements. In general, the findings imply that most Ohio banks may be placing more importance on evaluating the equity position of their farm borrowers (probably for collateral purposes, as well as for purposes of satisfying bank examiners) over evaluating the income producing ability of their farming operations.

Nearly one-fourth of the respondent banks had at least one individual on their staff who specialized in working with farmers on bank matters. However, only 8 banks employed a full-time agricultural or farm specialist while 49 had one or more staff members who devoted part of their time to agricultural lending activities. Large banks with $20 million and over in deposits accounted for three-fourths of the full-time specialists. Moreover, banks with deposits of $10 million and over employed 62 percent of all the full and part-time specialists. Only 6 of the 179 surveyed banks who presently were not employing a specialist and held deposits in excess of $10 million indicated plans to do so within the next 1-5 years. The high number of banks (173) which did not intend to employ a specialist in the future may suggest that most banks in Ohio are not planning to appreciably increase their commitment to agricultural lending. A farm specialist usually is employed to attract farm loans, to promote the public relations image of banks, and to provide financial and advisory service to farmers. Furthermore, by not employing specialized farm lending personnel, some banks in Ohio probably will be hard pressed to continue to compete with other farm lending institutions which specialize solely in the extension of farm credit. In general, it can be concluded that during the next 1-5 years, very little increase can be expected to occur in the present number of Ohio banks employing a full- or part-time agricultural specialist.

Only 6 percent of the surveyed banks presently offered at least one computer customer service to farmers or to agriculturally related business firms. Of the banks not offering any type of computer service, approximately 14 percent were planning to offer some type of service during the next 1-5 years. Nearly half of these banks held deposits in excess of $10 million. A somewhat higher proportion, approximately 22 percent of the surveyed banks were offering at least one or more special banking business services such as estate planning, other trust department services, taxes, or farm management consultation to farmers. These banks were predominantly large banks with $20 million and over in deposits. Only 9 banks presently not offering a special business service to farmers planned on doing so in the future. Thus, it generally can be concluded that very little change can be expected to occur in the number of Ohio banks offering special business services (other than computer) to farmers over the next 1-5 years. Additionally, the fact that only a few of the respondent banks presently were offering some type of computer customer service or other special banking business service to farmers or planned to do so in the future may be another indication of the future role of Ohio banks in the field of farm credit.

Only 8 percent of the surveyed banks had originated and consumated farm loan participation agreements with their correspondent banks during

1970 & 1971. More than half of these banks had originated participation loans to accomodate farm loan requests exceeding their legal lending limit. About four-fifths of these banks reported that they had received all of the outside funds which they had requested. In contrast, most of the surveyed banks indicated that they did not request or did not require correspondent bank credit for farm loan purposes during the past two years. However, some of the surveyed bankers indicated that they were very dissatisfied with their correspondent banks in terms of their provision of farm credit services. About 9 percent of the surveyed bankers reported that they had experienced difficulty in obtaining additional farm loan funds, or, in fact, were unable to obtain such funds from their correspondents because their correspondent banks were very reluctant to participate in farm lending.

Overall, based upon the findings which indicated that the surveyed bankers held negative attitudes toward the adequacy of the correspondent banking system's farm credit services, as well as the problems encountered by some of the banks in accommodating all of their overline farm loan requests, it can be concluded that the correspondent banking system as a whole is not adequately satisfying the farm credit needs of all of the respondent banks. Also, based upon the negative attitudes held by both agricultural and non-agricultural bankers, it can be concluded that some of the surveyed banks may not have requested correspondent banking farm credit services during 1970 and 1971 because they probably felt that they would not receive outside farm loan assistance even if it were requested. On balance, it appears that the correspondent banking mechanism cannot be entirely relied upon by Ohio banks as an outside source of bank credit or farm loan funds. This especially applies to those banks which are experiencing difficulty or probably will experience difficulty in the future in terms of meeting all of the farm credit needs of their farm loan customers from their own resources.

Implications of the Study

While the attitudes of bankers were positive toward agricultural lending, it appears that banks probably will continue to place more emphasis on other types of bank loans within their loan portfolios. Furthermore, because of the magnitude of their legal loan limits, larger banks can be expected to experience less difficulty, as compared to smaller banks, in financing the credit needs of farm borrowers requiring extremely large loans. Unless smaller banks are able to increase the size of their legal lending limits and/or are able to obtain outside sources of farm loan funds in sufficient quantities, they probably will experience considerable difficulty in maintaining their present share of the farm loan market in the future. Also, smaller banks will need to attract new deposits in order to facilitate expansions in their farm lending programs in view of their high loan-to-deposit ratios. Thus, a major implication of this research is that the farm lending commitment of most banks in Ohio, as well as their future role in the field of farm credit will be more a function of the economic framework (e.g., resource limits and other constraints, asset and liability management alternatives) and legal environment (e.g., bank structure, legal lending limits) in which they carry on the business of banking, rather than a function of bankers' perceptions and/or attitudes about agricultural lending.

With respect to the future role of Ohio banks in the field of farm credit, there are several reasons which suggest the importance of this role both from the viewpoint of benefiting banks which may actively participate in farm lending activities, as well as from the viewpoint of benefiting the agricultural sector and the banks' local communities. First, banks can make a strong contribution to the efficiency with which food and fiber is produced by allocating loan resources to the more efficient producers in Ohio's agricultural sector. Second, banks can stimulate growth in the level of business activity of their local communities, and thereby can increase their own level of banking activity if they make a strong effort to service the credit needs of acceptable farm borrowers. Third, banks can obtain new deposits and new business from old customers, as well as attract new customers and new deposits if they wisely channel funds into agriculture. Fourth, banks should be able to retain existing customers who may otherwise be lost to competitors if they establish a strong commitment to agricultural lending. Finally, if banks maintain a strong farm lending commitment, they should be able to develop opportunities for other kinds of business such as estate planning, trust services, farm management consulting, and farm record keeping services, in addition to the usual provision of bank credit to farmers.

Banks in Ohio hold a unique position in the field of finance. Specifically, among all major farm lending institutions, they presently are the only institutions which are in a position to offer complete, "one stop" financial services to farmers such as short-term, intermediate-term, and farm real estate credit, as well as checking and savings accounts, trust department services, record keeping services, safe deposit facilities, and management advisory services. In addition, most banks are readily accessible to Ohio farmers since they are strategically located throughout the state. However, unless most banks in Ohio recognize the potential importance of their future role in financing agriculture, take advantage of their unique position in the field of finance, and subsequently become more aggressive in providing credit and related services to farmers, it is reasonable to expect that their role in agricultural lending probably will decline in the future. A gradual withdrawal of Ohio banks from the field of farm credit, however, may pose a potential loss to the agricultural sector, since banks in Ohio traditionally have been the dominant suppliers of farm credit.

While the Farm Credit System's agencies (Federal Land Banks and Production Credit Associations) have substantially increased their role in financing agriculture, they probably can not be expected to accommodate all of the agricultural sector's anticipated credit needs during the 1970's. Banks will need to share in financing agriculture as well, if the agricultural sector is to continue to become more efficient in its production of food and fiber. Also, the recently passed Farm Credit Act of 1971 has considerably broadened the Farm Credit System's activities both in the area of farm finance and in the area of rural development. The Farm Credit Act of 1971 evolved primarily because of a void in these two areas which apparently was not being filled by banks and other financial institutions. The expanded activities of the Farm Credit System include, for example, mortgage financing of rural nonfarm homes, financing of farm related businesses, and the offering of financially related services such as trust and estate management, tax services, and electronic record keeping where these services are not otherwise available. Unless banks make a strong effort to maintain and/or increase their role in financing agriculture, additional legislative amendments to the Farm Credit Act of 1971, which would broaden the activities of the Farm Credit System even more, could be expected. Consequently, if banks do not attempt to maintain a strong commitment to agricultural lending, they not only face the possibility of gradually being taken out of agriculture by their non-bank competitors, but they also face the possibility of losing potentially good business in the area of rural and community development. Thus, another major implication of this study is that if Ohio banks are to maintain a leadership position among the state's agricultural lenders, then it will become necessary for them to strengthen their financial service strategies in the field of farm credit.

The results of the research clearly identify some important areas in which Ohio banks could initiate changes in their present farm lending practices and activities associated with merchandising agricultural credit and related business services to farmers. The comparatively low priority banks appear to be giving to farm loans may be partially a result of bankers unfamiliarity with agricultural credit and its terms. This was suggested by the relatively low number of banks presently employing specialized personnel in the field of farm finance, as well as by current loan documentation procedures used by most banks in the analysis of agricultural loan applications. If banks are to actively compete with other competing farm lenders which specialize in the extension of farm credit, they will need to employ more specialized personnel who can provide sound financial assistance and advisory service in the extension of credit to farm borrowers. However, while all banks can not be expected to have the resources to employ a full- or part-time agricultural specialist, it also appears that the establishment of some type of educational program in agricultural lending would be beneficial to all banks in terms of adding to their knowledge and understanding of agricultural credit and its terms.

While agricultural or farm specialists could provide expert assistance with respect to the allocation of a bank's loan resources to agricultural lending, they also could provide additional help in developing better correspondent arrangements between city and rural banks. This could be especially valuable to those rural banks in Ohio which presently are in need of outside farm loan assistance and/or which probably will need to obtain outside funds in the future. Based upon the existing bank structure in Ohio, the correspondent banking mechanism presently appears to be the most accessible method by which many rural banks can gain access to additional sources of farm loan funds. Although the research findings indicated that bankers were generally dissatisfied with the adequacy of the correspondent banking system's farm credit services, the problem may not entirely rest with the city correspondents. Rural banks also could become more aggressive in soliciting farm loan assistance from their correspondents. If rural banks are to gain outside farm loan assistance from their correspondent banks, it probably will be necessary for rural banks to gain the confidence of their correspondents by demonstrating that they have the capability and expertise to service the farming sector. An agricultural specialist could assist in initiating efforts to educate his bank's city correspondents about agricultural credit and its terms. In addition, while some of the smaller banks probably do not have the capabilities to offer specialized banking farm business services to farmers such as estate planning, trust services, taxes, farm management consulting, and farm record keeping, they probably could obtain at least one or more of these kinds of services for their farm customers through their correspondents.

A possible area in which rural banks could improve their correspondent banking relationships appears to be in the area of loan documentation. While most of the farm customers of banks are required to submit financial statements (net worth) as part of their loan applications, operating statements, farm budgets and cash flow schedules were not widely required from most of the banks' farm loan customers. If rural banks were to place more emphasis upon utilizing these latter types of financial statements in analyzing farm credit applications, especially from borrowers requiring extremely large loans which might necessitate outside farm loan assistance, rural banks should be able to strengthen their requests for loan participation agreements from their correspondents. A farm specialist could be an important asset in this area. Furthermore, if banks are to maintain a role consistent with the current full-service concept of banking, it appears that banks could initiate programs to educate their farm clientele in preparing adequate financial records. This could be beneficial both from a farm customer's perspective in terms of improving his ability as a financial manager, as well as from a bank's perspective in terms of generating improved farm customer banking relationships over time. Specifically, by assisting a farm borrower in this area, a bank could help a farmer to increase his income and to increase his banking business both in the area of credit as well as in the area of related business services.

Overall, the future role of Ohio banks in the field of farm credit will depend not only upon the aggressiveness of banks in the field of farm finance, but also upon the employment of personnel who are knowledgeable about agricultural credit and its terms, and also upon the development of better correspondent banking credit service arrangements between rural and city banks. In many instances, this will require cooperation throughout the banking system in Ohio if banks are to maintain and/or increase their role in financing agriculture.